**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

| | | |
|---|---|---|
| In the Matter of | ) | |
| Developing a Unified Intercarrier | ) | CC Docket No. 01-92 |
| Compensation Regime | ) | |

# INITIAL COMMENTS OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION


L. Marie Guillory
Daniel Mitchell
Jill Canfield

Its Attorneys

4121 Wilson Blvd.
Tenth Floor
Arlington, VA 22203

TABLE OF CONTENTS

## SUMMARY

NTCA urges the Commission not to proceed with its rulemaking on intercarrier compensation. Changing intercarrier compensation rules in the manner proposed will have a dramatic and perhaps devastating impact on consumers living in rural areas and the carriers that serve them. The proposals are incomplete and have not been thoroughly thought through. The NPRM is premature and should be set aside while the Commission considers the relationship and impact of numerous related issues.

Rural carriers continue to face uncertainty about rural access rates and have no practical experience to properly comment on the effects of this proposal. There are also pending petitions for reconsideration and clarification of the Commission's order on intercarrier compensation for ISP-bound traffic, and on rural universal service. The Supreme Court is also reviewing the issue of whether the FCC's FLEC methodology for pricing of interconnection and unbundled network elements is appropriate under the Act. The Commission must resolve these issues and allow the new access regime for ROR carriers to work before it pushes forward with a new compensation regime. Rural companies should have the same level of certainty and predictability concerning their access rates as the Commission afforded non-rural carriers before the Commission moves forward and creates additional uncertainty.

The universal service impact of the Commission's proposals is astounding. The Commission pays no attention to the Act's basic universal service principles of ensuring access in rural and high cost areas, comparable and affordable rates, and specific,

predictable and sufficient Federal and State support mechanisms. The average subscriber of a carrier participating in the NECA pools will see an increase of $20 in her end user charges. The impact is more devastating as the carriers get smaller. Subscribers in small study areas with 500 or less lines will see an average end user charge increase of $69 per month. Subscribers in study areas with 500 to 1,000 lines will see an average increase of $46 per month. These increases will hit rural consumers in high cost areas most drastically**.** The Commission offers no universal service funding proposals to offset these huge increases to end user charges.

Further, the Commission fails to take into account Federal and State jurisdictional separations. Adopting and implementing a new unified intercarrier compensation regime without first accounting for jurisdictional separations may improperly preempt State commission jurisdiction and raise issues of confiscation. The Commission's proposal would shift significant portions of carrier costs from the interstate to the intrastate jurisdiction, as much as $175 on the extreme end. Because huge shifts are predictable, the Commission must refer the matter to the Federal-State Joint Board on Separations as required by the Act.

The Commission presents its proposals as sound economic decision-making, but several of its basic assumptions are flawed or open to other interpretations. Both the COBAK and BASICS proposals are predicated on the assumption that both the calling and called parties benefit from a completed call, and should share in its cost. However, only the calling party has complete information. The called party may not know who is on the other end of the line. Economists have long recognized this sort of asymmetric information as an impediment to the establishment of efficient markets. Further the

Commissions intercarrier compensation proposals may encourage inefficient use of network resources. Because the terminating costs of a call is passed along to the called party's carrier, the proposals provide incentives to the calling party to place calls that would not be cost effective under the current regime.

The Commission makes no attempt to tailor the NPRM to the unique circumstances of rural areas. It fails to analyze the effect its "one size fits all" proposals will have on rural consumers and the carriers that serve them. The Commission ignores that there are almost 1000 carriers serving the equivalent of one central office code of a large carrier. The Commission should change the intent of its proposals. Rather than seeking to create new rules, the Commission should be gathering information at this stage. It should either postpone or convert this proceeding into a Notice of Inquiry. In any event, the Commission should not act without referral to the Federal and State Joint Boards on Separations and Universal Service.

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

| | | |
|---|---|---|
| In the Matter of | ) | |
| Developing a Unified Intercarrier | ) | CC Docket No. 01-92 |
| Compensation Regime | ) | |

# INTIAL COMMENTS OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

The National Telephone Cooperative Association (NTCA)[1] respectfully submits its comments in the above proceeding.

## I. THE NPRM IS PREMATURE.

The Commission should not proceed with a rulemaking on intercarrier compensation before it resolves access restructure for rate of return companies and it has the opportunity to observe the effect of these changes on rural consumers, rural carriers, and the markets they serve.

Rural companies should have the same level of certainty and predictability concerning their access rates as the Commission provided non-rural carriers. Those carriers, at least, have some experience operating under the new access regime adopted in the CALLS Order.[2] As a result of the CALLS Order, non-rural carriers have predictable

[1] NTCA is a non-profit corporation established in 1954. The association represents nearly 550 rural incumbent local exchange carriers (ILEC). Its members are full service telecommunications companies providing local, wireless, cable, Internet, satellite and long distance services to rural communities throughout the United States. All members are small carriers and defined as "rural telephone companies" in the Telecommunications Act of 1996 (Act). NTCA member companies are dedicated to providing competitive modern telecommunications services and ensuring the economic future of their communities in rural America.

[2] *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users, Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262 *et al*., Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, FCC 00-193, 15 FCC Rcd 12962 (2000) (the "*CALLS Order*").

access rate levels until the year 2005 and have gained valuable experience under the plan over the last year. Conversely, Rate of Return (ROR) carriers, which include mostly rural telephone companies continue to face uncertainty about rural access rates and have no practical experience under a post 1996 Telecom Act regime to properly comment on the effects of this intercarrier compensation proposal. The Commission therefore should stay the NPRM until rural companies have an ample opportunity to experience the effects of the FCC's rural access reform measures as a result of its approaching ROR access reform order, which will consider reform of rate of return carrier rates.[3]

The Commission also has five pending petitions for reconsideration and clarification concerning its order on intercarrier compensation for ISP-bound traffic.[4] In the ISP order, the Commission required carriers under certain circumstances to apply its new ISP rates to non-ISP local traffic. Petitioners assert that this requirement wrongly preempts state commission jurisdiction to arbitrate and approve cost based rates for the transport and termination on non-ISP local traffic under sections 251 and 252 and erroneously vacates previous state commission determinations concerning this traffic.[5]

---

[3] *In the Matter of Federal-State Joint Board on Universal Service, Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Fourteenth Report and Order, Twenty-Second Order on Reconsideration (Order), and Further Notice of Proposed Rulemaking (FNPRM*),* CC Docket Nos. 96-45, 00-256, FCC 01-157 (rel. May 23, 2001) (Fourteenth Report and Order).

[4] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Intercarrier Compensation for ISP Bound Traffic,*Order on Remand and Report and Order, CC Docket Nos. 96-98 and 99-68, FCC 01-131 (rel. April 27, 2001) (ISP Order).

[5] *See Joint Petition for Reconsideration filed by Choctaw Telephone Company, Electra Telephone Company, Haxtun Telephone Company, Mokan Dial Telephone Company, Park Region Mutual Telephone Company, South Dakota Independent Telephone Coalition, Tatum Telephone Company, and Walnut Hill Telephone Company,* CC Docket Nos. 96-98, 99-68 (June 14, 2001); and *Petition for Reconsideration and/or Clarification filed by the Independent Alliance on Inter-carrier Compensation,* CC Docket Nos. 96-98, 99-68 (June 14, 2001) and NTCA Comments in support (August 2, 2001).

The FCC proposes in the NPRM to unify the two current intercarrier compensation regimes: (1) access charges for long-distance traffic; and (2) reciprocal compensation charges for local traffic. Section 252(d)(2), however, provides state commissions, not the FCC, with jurisdiction to establish compensation arrangements and set rates for the transport and termination of local traffic under section 251(b)(5) of the Act. State commissions have explicit statutory authority and jurisdiction under section 252 to adopt intercarrier compensation regimes for local traffic where they deem them appropriate. The FCC may only approve arrangements for the transport and termination of 251(b) traffic if a State Commission fails to act.[6]

The Commission should stay further comment on the NPRM until a final resolution of the jurisdictional issues related to section 251(b)(5) traffic are resolved. These issues are at stake in the pending petitions for reconsideration of the ISP Order. Adoption of a post-CALLS/MAG unified intercarrier compensation regime prior to determining the extent of the Commission's jurisdiction over local voice and data traffic would place a cloud of doubt over the legality of a new unified compensation system and encourage appeal.

The Commission has several reconsideration and clarification petitions pending on its recent rural universal service support order.[7] The U.S. Court of Appeals for the 10th Circuit has also recently reversed and remanded portions of the FCC's non-rural carrier universal service support order.[8] The Court concluded that the Commission cannot ignore the overall impact of its federal funding decisions. The instruction from

---

[6] 47 U.S.C. § 252(e)(5), Communications Act of 1934 as amended by Telecommunications Act of 1996, Pub.L. No. 104-104, 110 stat. 56 (1996) (The Act) hereafter, citation to the Act is by section number.

[7], Fourteenth Report and Order.

[8] *Qwest v. Federal Communications Commission,* __ F.3d _, WL 864222, 10th Cir. (July 31, 2001).

*Qwest* is that the Commission should first resolve the universal service issues on reconsideration and remand, and then establishing adequate Federal and State universal service support mechanisms to absorb the impact of a newly adopted unified intercarrier compensation regime. Otherwise, the Commission runs the serious risk of violating section 254 of the Act .

The "bill and keep" compensation proposals under consideration in the NPRM, if adopted, would shift substantial costs from the interstate to the intrastate jurisdiction.[9] This would have a significant impact on carrier universal service support and would require that intrastate rates increase substantially to recover lost interstate access revenues.

Section 254 contemplates a partnership between the federal and state governments to ensure specific, predictable and sufficient universal service support and to establish Federal and State mechanisms to preserve and advance universal service. It also requires that the Commission determine the impact of a new intercarrier compensation proposal on the sufficiency of universal service funding for achieving comparable rural and urban rates for basic service. As the Commission recently experienced, failure to adequately induce state mechanisms to support universal service and explain how federal support for universal service relates to other funding mechanisms prior to adopting and implementing a new mechanism violates section 254 of the Act.[10]

Lastly, the NPRM raises the issue of whether access charges that are based on embedded cost should be moved to forward-looking-economic cost (FLEC), if a bill and

[9] Bill and keep refers to an arrangement in which neither of the two interconnecting networks charges the other for terminating traffic that originates over the other's network.
[10] *Quest v. FCC.*

keep compensation system is not adopted.[11] The United State Supreme Court is currently reviewing the issue of whether the FCC's FLEC methodology for pricing of interconnection and unbundled network elements (UNEs) is appropriate under the Act.[12] If the Supreme Court decides that the FLEC methodology is inappropriate or that it is only appropriate in limited circumstances, the legality of using a FLEC model for access charges would be seriously questioned. Absent the Supreme Court's decision, it is premature for the Commission to consider whether FLEC would be appropriate for determining intercarrier access charges.

In view of these unresolved proceedings and the lack of experience with access restructure for ROR carriers, the Commission should either treat this proceeding as a Notice of Inquiry or postpone the NPRM until it has resolved these issues and obtained some experience with an access reform regime for ROR carriers**.** This approach will enable all parties to understand fully the foundations on which the future intercarrier compensation proposals in the NPRM would be built.

## II. THE COMMISSION FAILS TO FULLY CONSIDER THE RAMIFICATIONS OF A BILL AND KEEP REGIME AND IGNORES THE UNIVERSAL SERVICE MANDATES OF THE ACT

A policy of universal service and its financial support is vital to the continued viability of rural telephone companies and the communities they serve. Telephone service provides a vital link between individuals and emergency services, government services, and surrounding communities. The goal of universal service is to ensure that "customers in all regions of the nation have access to telecommunications services."[13] In

[11] *NPRM,* at para. 99-111.
[12] *Iowa Utilities Board v. AT&T,* 219 F.3d 744 (8th Cir. 2000)(*Cert*. granted).
[13] *In the Matter of Federal-State Joint Board on Universal Service,* Ninth Report and Order and Eighteenth Order on Reconsideration, FCC 99-306, CC Docket No. 96-45 (Nov. 2, 1999).

recognition of the intrinsic value of ubiquitious, nationwide telephone service, Congress codified its continued commitment to preserving universal service in Section 254.[14]

The Act provides certain principles that are to guide the Commission as it adopts its policies and rules. First and foremost, the Commission is to preserve and advance universal service. In furtherance of that goal, the Commission is to ensure service affordability, access and comparability.

The Commission ignores these important universal service principles and pays them no attention in its NPRM. The bill and keep proposals could significantly and detrimentally affect universal service and the price for telecommunications services paid by consumers living in high cost areas. NECA's comments demonstrate that average end user charges in rural areas could see rate hikes of $ 20.00 per month when the combined interstate and intrastate effects are accounted for.[15]

### A. Because a bill and keep intercarrier compensation regime would significantly and detrimentally affect universal service, the Commission must first refer the NPRM to the Federal-State Joint Board on universal service

Because a change in the intercarrier compensation rules will affect universal service, the Act dictates that the Commission refer the matter and receive recommendations from a Federal-State Joint Board. The Commission has made no such referral. Further, it is a wholly inappropriate time to propose anything that will significantly affect the funding mechanisms for small and rural carriers.

[14] 47 U.S.C.§254.

[15] *See,* Appendix I to NECA Comments filed in this proceeding on August 21, 2001 (NECA Appendix I)

### 1. A Joint Board will need to consider and explain how the proposed intercarrier compensation regime will affect universal service

Congress directed the Commission to preserve and advance universal service and base its policies on principles that ensure access to telecommunications and information in rural and high cost areas, comparable and affordable rates, and specific, predictable and sufficient Federal and State support mechanisms. There are many issues involved in determining whether any particular plan will meet Congress' universal service goals and all must be fully considered. The Commission "may not depart from [basic universal service principles] to achieve some other goal."[16]

As explained more fully below, changing the intercarrier compensation regime without a similarly drastic change in universal service funding will cause the rates paid by end users, particularly in high cost areas, to rise. As rates rise, they may become unaffordable. Also, since urban and rural costs are not comparable, under a bill and keep regime, the rates for basic telephone service would not be comparable. Intercarrier compensation and universal service are perpetually intertwined.

The U.S. Court of Appeals for the 10th Circuit recently recognized this relationship when it realized that it could not fully consider whether the Commission properly reformed universal service without also considering the reform to interstate access charges.[17] Similarly, it is not possible to consider reforming intercarrier compensation without simultaneously considering the impact the action will have on

---

[16] *Qwest v. FCC,* 2001 WL 864222 at * 5.

[17] The 10th Circuit explained because the Commission had not addressed the implicit federal support built into interstate access charges, the Court could not know the full extent of federal support for universal service. It therefore could not review the sufficiency of the Commission's actions. The Court said that on remand, "the FCC will have an opportunity to explain further its *complete* plan for supporting universal service." *Qwest v. FCC,* 2001 WL 864222 at *10.

universal service. The Commission may not reform intercarrier compensation unless it explains and addresses the effect the regulation changes will have on the basic universal service principles of affordable and comparable rates, and the requirement of specific, predictable and sufficient Federal and State universal service support mechanisms.

### 2. The proposals have state implications that must be referred to the Federal-State Joint Board on Universal Service

Section 254(a)(1) of the Act directs the Commission to create a Federal-State Joint Board and refer to it proceedings to recommend changes to any of its regulations in order to implement Section 254 itself and Section 214(e) of the Act.[18] This intercarrier compensation proceeding will affect and likely necessitate changes to universal service, yet the Commission has not referred any portion of the NPRM to the Joint Board for a recommended decision.

In recognition of the complexities of universal service and of the often competing interests, Congress directed that a universal service joint board be made up of both Federal and State representatives and a utility consumer advocate.[19] The Joint Board is required to prepare a recommended decision to the Commission and the FCC is required to afford State members of the Joint Board an opportunity to participate in the Commission's deliberations in the proceeding. The public should then be given the opportunity to comment on the recommended decision. This ensures that the Commission has heard the voice of all interested parties and enables it to make a well-reasoned decision.

[18] 47 U.S.C. § 254(a)(1).
[19] 47 U.S.C. §§ 254(a)(1), 410(c).

Intercarrier compensation reform may have a devastating impact on the basic principles of universal service. If ever there was a matter appropriate for Joint Board review, bill and keep is it. However, there has been no referral to the Joint Board, no recommended decision from the Joint Board and no public comment on the Joint Board's recommendation. It is, at the very least, premature for the Commission to propose and request public comment on new rules for intercarrier compensation.

### B. The intercarrier compensation proposals may cause end user rates to rise beyond "affordable" levels as required in the Act.

The Commission's bill and keep proposals force each carrier to recover the costs of origination and termination from its own end-user customers. This scheme will necessarily push end-user rates up and blur the line between interstate and intrastate cost allocation and ratemaking . The Telecommunications Act tells the Commission that "[q]uality services should be available at just, reasonable, and affordable rates."[20] While "affordability" has never been defined by the Commission, the Commission concedes that a bill and keep regime would result in an increase in flat-rated end-user charges and that higher fixed rates may cause certain subscribers to drop off the network.[21] The National Exchange Carrier Association (NECA) comments demonstrate that a bill and keep regime will drive the price of telecommunications services out of the range of affordability in rural areas. NECA estimates that the combined intrastate and interstate bill and keep impact for LECs with less than 500 lines is $69 per month per end user. It

[20] 47 U.S.C. §254(b)(1).
[21] NPRM paras. 123, 124.

is $46 for LECs with 500 to 1,000 lines.[22] These smaller LECs typically serve more sparse rural areas and have higher relative costs than more dense rural areas.

The Commission must look at all end user charges to determine affordability and not determine that on average, rates are affordable.[23] As discussed more fully below, a bill and keep regime will disproportionately affect the rates paid by subscribers of small and rural telephone companies. An intercarrier compensation scheme which forces even a minority of subscribers to drop service because it is no longer affordable is flawed and contradicts the Act.

### C. Bill and Keep will disproportionately affects the rates paid by rural consumers, contradicting the comparability requirements of the Act

Closely related to the concept of affordability, is comparability. Without sufficient support, the cost of service for consumers living in high-cost areas will rise far beyond the cost for those living in low-cost urban areas. Neither the service, nor the price paid for it will remain comparable as required by the Act.

Section 254(b)(3) states that "[c]onsumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high-cost areas, should have access to telecommunications and information services . . . that are reasonably comparable to rates charged for similar services in urban areas."[24] The bill and keep proposals require carriers to recover their costs directly from their own end users and do not propose any universal service mechanism to ameliorate the effect of disproportionate impacts an end users in rural or high cost areas. Because urban and rural costs are not

---

[22] *See,* NECA Appendix I.

[23] The 10th Circuit found that comparing rates within a state's borders and among states nationwide was inadequate. *Qwest v. FCC,* 2001 WL 864222 at *9.

comparable, under a strict bill and keep regime, urban and rural rates could not be comparable. It is more expensive for telecommunications providers to serve rural areas than urban areas. Fewer subscribers and lower subscriber density translate into higher costs. The population density for areas served by rural carriers averages to only 13 persons per square mile, compared with 105 persons per square mile in areas served by non-rural carriers.[25] As was pointed out by the Rural Task Force, the total investment in plant per loop is substantially higher for rural carriers compared to non-rural carriers. On average, total plant investment per loop is more than $5,000 for rural carriers compared to less than $3,000 for non-rural carriers.[26] Further, average total plant investment per line for rural carriers increases as the line size of the study area decreases. Average plant investment per line ranges from 3,000 for rural carriers with the largest study areas to more than $10,000 for carriers with the smallest.[27]

There is a substantial difference between the costs of large carriers and those of small carriers. A strict bill and keep regime that forces a carrier to recover all of its costs directly from its end users would cause rural rates to skyrocket. Bill and keep is untenable without sufficient support for rural-urban comparable rates and services. The need for support implicates Section 254 and necessarily calls for referral to a Federal-State Joint Board.

---

[24] 47 U.S.C. § 254(b)(3).
[25] Rural Task Force, *The Rural Difference,* White Paper, 8 (Jan. 2000) <http://www.wutc.wa.gov/rtf.>
[26] *Id.* at 12.
[27] *Id.*

## D. COBAK Will Unreasonably Shift Very Large Amounts Of Charges To End Users

NECA has performed an analysis of the impact of COBAK for rural study areas. The analysis includes Traffic Sensitive Switched revenue requirements for 1241 rate of return study areas.[28] The analysis indicates that the smaller the company the larger the increase in monthly end user charges. As we have previously stated in Section II,B this has significant implications for affordability, comparability and universal service.

For July 1, 2003, NECA projects a total interstate access charge revenue requirement of $2,973 million. Under today's rules without any changes in current Subscriber Line Charges (SLCs) of $6.00 for multi-line business lines and $3.50 for residential and single-line business lines, per minute access rates would recover $1621 million, $593 million would come from SLCs, and $759 million would come from Local Switching Support (LSS) and Long Term Support (LTS). In 2003, using today's methods and SLCs, 55% of total interstate access charges will be recovered from IXC's as per minute access charges.

The shift to end users which would occur with the imposition of COBAK would be burdensome and inequitable. NECA projects that setting per minute access rates to recover just 50% of Switched and Dedicated Access costs would reduce access charges paid by IXCs to $136 million, less than 5% of total access revenue requirements.[29] This is more than a ten fold decrease in the portion charged IXCs in current per minute rates. Such a drastic change is unreasonably low and bears no relationship to traditional

---

[28] NECA Appendix I.

ratemaking principles that dictate the allocation of joint and common cost among cost causers. There is no evidence or theoretical support demonstrating that the IXCs should bear as limited a burden as 5% of the interstate revenue requirement.

The cost shift is also unreasonable from an end user perspective. Taking into account interstate and intrastate impacts, average total monthly end user charges per subscriber would increase from between $7.70 for rural study areas with over 50,000 lines to $46.10 for rural study areas with less than 500 lines.[30] It is obvious from this data that the Commission should not proceed without fully understanding the cost shifts, which would be imposed upon rural consumers.

### E. A Bill and Keep Regime circumvents Congress' intent in enacting the geographic rate averaging requirement of Section 254(g).

The Commission's intercarrier compensation proposals reduce the portion of a customer's total bill that is subject to the rate averaging requirement, thus defeating the purpose of geographic toll rate averaging. Section 254(g) of the Act commands the Commission to "adopt rules to require that the rates charged by providers of interexchange telecommunications service to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas."[31] The intended effect of this section relating to toll service is similar to that of the comparability requirements of Section 254(b)(3). Section 254(g) codified a national policy aimed at keeping the rates and services available to rural and urban consumers on a level playing field. Congress recognized the intrinsic value of a ubiquitous, reasonably

---

[29] NECA Appendix I.
[30] NECA Appendix I.
[31] 47 U.S.C. § 254(g).

priced telecommunications system. The Commission cannot ignore the statutory command or substitute its judgment for that of Congress in the interest of purported regulatory simplicity**.**

The bill and keep proposal destroys ubiquity and the success of a federal-state regime based on decades of cooperation aimed at ensuring a nationwide system of adequate an affordable service by doing away with much of the current toll system and shifting more of the costs onto the local bill. Regional toll providers do not have the nationwide network of the major interexchange carriers over which to average their costs. It is likely that consumers living in high cost areas will end up paying more for intrastate toll and interexchange service than those living in urban, low cost areas. The reality and purpose of geographic toll rate averaging will be lost.

## III. FEDERAL AND STATE JURISDICTIONAL SEPARATIONS MUST BE TAKEN INTO ACCOUNT WHEN CONSIDERING A NEW UNIFIED INTERCARRIER COMPENSATION REGIME

Before the Commission can adopt and implement a new unified inter-carrier regime it must first refer the NPRM to the Federal-State Joint Board on Separations. The Act requires that the FCC refer to the Joint Board on Separations any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations instituted pursuant to an NPRM.[32] The proposals in the NPRM would alter existing separations rules by shifting substantial costs from the interstate to the intrastate jurisdiction. The Commission cannot look the other way and pretend that this result is not a separations change that, in fact, results in dictating local rates increases.

[32] 47 U.S.C. § 410(c).

Adopting and implementing a new unified inter-carrier compensation regime without first accounting for jurisdictional separations may improperly preempt State commission jurisdiction and raise issues of confiscation. Under the two bill and keep regimes proposed in the NPRM, significant portions of carrier costs would be shifted from the interstate to the intrastate jurisdiction. NECA estimates that the shift to end users from interstate could be as great as $175.[33] This shifting of costs and charges by the FCC to the intrastate jurisdiction will disturb the allocations of costs that Part 36 recognizes without reference to a Joint Board under Section 410(c), the FCC will improperly preempt "state commission jurisdiction to estimate the value of property used in the provision of intrastate service and determine the revenues and expenses properly attributable thereto."[34]

In *Smith v. Illinois*, the Supreme Court stated that "proper regulation of rates can be had only by maintaining the limits of state and federal jurisdiction" to determine whether rates would result in confiscation.[35] The Court held that when distinct jurisdictional limits exist as to the determination of reasonable rates, some form of jurisdictional separations must occur. The Court established that "reasonable measures [are] essential" and indicated that such measures should not "ignore altogether the actual uses to which the property is put."[36] The Commission's actions in this proceeding should therefore take into consideration state commission jurisdiction and the separation of carrier property and expenses between interstate and intrastate operations in order to

33 NECA Appendix I.
34 *Smith v. Illinois Bell Telephone Co.,* 282 U.S. 133, 51 S.Ct. 65 (1930).
35 *Id.*
36 *Id.*

avoid issues of preemption and confiscation. Referring the NPRM to the Joint Board on Separations would assist the Commission in properly addressing these issues.

## IV. THE PROPOSALS DO NOT GUARANTEE THE ELIMINATION OF REGULATORY ARBITRAGE OPPORTUNITIES

Both the COBAK and BASICS regimes are touted as economically sound methods of eliminating much of the inequity and inefficiency that exists in today's telephone industry. While these regimes may pose a theoretical solution to some of the problems currently plaguing "calling party network pays" (CPNP) regimes, in reality, implementation of either plan would create both winners and losers. Unfortunately, the losers would likely be high cost areas and those who could afford it the least.

### A. Some of the assumptions underlying the COBAK and BASICS proposals as put forward in the NPRM are either dubious or false.

Both COBAK and BASICS are predicated on the assumption that both the calling and called parties benefit from a completed call, and thus should share in its cost. In reality, only the calling party has complete information. The called party, on the other hand, often does not know who is on the other end of the line. Under the COBAK and BASICS proposals, however, the called party incurs a charge when the call is answered. It is entirely likely that the incoming call might be one that the called party does not wish to receive—much less pay for.

Telemarketing is a prime example of a call whose perceived value might not be equal for the calling and called parties. The calling party—the telemarketer—has complete information. He or she knows whom they are calling, where they live, that she is a good candidate to purchase the product being sold, in addition to some demographic information. In economic terms, the expected value of the sales directly resulting from a series of calls must exceed the cost of those calls (assuming that the telemarketer is rational) or else the calls will never be made. The telemarketer requires a certain level of information in order to determine what the expected value of the sales resulting from those calls will be. The called party, on the other hand, has relatively little (if any) information at his or her disposal. She doesn't know who is calling, what they are calling about, or why they decided to call her. The only way for the called party to be able to get additional information is to answer the call. Under the COBAKS and BASICS proposals, however, doing so instantly incurs a cost.

Asymmetric information, as in the above example, has long been recognized as an impediment to the establishment of efficient markets.[37] When one party possesses information unavailable to the other party or parties, inefficiency inevitably results. The lack of knowledge is a great handicap, as decisions must then be based upon imprecise information. The less information available, the greater the likelihood that important decisions based upon the insufficient information will be inefficient.

There do currently exist means by which called parties can obtain information additional information about incoming calls, such as caller I.D. These, however, also pose additional costs (equipment, subscription fees, etc.) Further, the information provided by these services is limited, and can be abused to mislead the called party in order to coax the called party to answer the call. (A good analogy would be the recent trend toward advertising mail that comes disguised as an official government document or a check, done in order to entice the recipient to open the item rather than discard it unopened.)

---

[37] *See*, for example, William Nicholson, *Microeconomic Theory: Basic Principles and Extensions*, 4th ed., The Dryden Press, 1989.

A CPNP regime, on the other hand, insures that neither party pays more for the call than its perceived value to that party.[38] The same cannot be said for either COBAK or BASICS.

### B. While both COBAK and BASICS are predicated on the concept of efficiency, that is a nebulous concept

Efficiency is always determined relative to specific goals. Economic efficiency is typically defined as obtaining the most customer satisfaction from available resources.[39] The difficulty arises when trying to define customer satisfaction. As non-quantifiable factors enter into customer satisfaction, then efficiency does not necessarily mean lowest aggregate cost. As noted in the Telecommunications Act of 1996 ("Act"), other factors, such as ubiquity, and comparable and reasonably priced service, in addition to cost minimization are taken into account—particularly in rural areas.[40] For example, because the terminating cost of the call under COBAK and BASICS is passed along to the called party's carrier (and thus, ultimately, to the called party), COBAK and BASICS, in effect, provide incentives to the calling party to place calls that otherwise would not have been cost effective under a CPNP regime. The net result, potentially, could be inefficient use of network resources.

## V. INTER-CARRIER COMPENSATION POLICY SHOULD BE TAILORED TO MEET THE UNIQUE ENVIRONMENT FACED BY COMMUNITY BASED RURAL LOCAL EXCHANGE CARRIERS

---

[38] Under CPNP, the calling party has sufficient information with which to make a cost/benefit decision about whether to place the call; the called party is not charged for answering the call and thus loses nothing but, at most, a few moments of his/her time.

[39]

[40] Cite universal service portion of Act.

The Commission makes no attempt to tailor the NPRM to the unique circumstances in rural areas or to analyze the effect its "one size fits all" proposal will have on small ILECs. These small ILECs typically derive more than 60% of their revenues from access. There rates and services will be impacted in a much more drastic way than carriers less reliant on access. There is a reason and years of history behind the heavy reliance on access. The telephone service areas of the independent rural incumbent local exchange carriers (ILECS) differ significantly from those of the major ILECS, which serve the large cities.[41] Rural carriers have approximately 8% of the access lines and serve about 38% of the land area and serve areas with only 13 persons per square mile versus 105 per square mile for the non-rural carriers. Furthermore, there is also a great diversity among the rural carriers. Almost 9% of rural carrier study areas have only 0.25% of the rural lines, while at the other extreme 1.5% of the study areas have more than 27% of the lines.[42] These huge differences make it very difficult to generalize and impose blanket solutions on rural carriers. An average of rural carriers is not a good predictor of the characteristics of any single rural company.

Despite the degree of variation among rural carriers certain patterns are discernable through a stratified analysis of characteristics based on study area size. Normalized on a per line basis, these characteristics emerge: the smaller the size of study area -- the lower the population density, the fewer the proportion of multi-line business customers, the greater the proportion of calls that are toll calls, and the greater the investment.[43]

---

[41] *See*, *The Rural Difference*, White Paper 2, a report prepared by the Rural Task Force, an independent panel appointed by the Federal-State Joint Board on Universal Service, (January 2000).
[42] *Id*., Figure 6.
[43] *Id*., Figures 7,8,12,13 and 17.

These high-level observations explain why extreme care is necessary before adopting a “one size fits all” solution. Furthermore, rural carriers have significant scope and scale issues. The number of customers they serve is less per switch, per route mile, per square mile or almost any other way to compare rural and non-rural. They have more switches, less traffic, transport the traffic longer distances and have much higher costs.

Second, there are numerous small carriers. Data for the 1241 non-price cap study areas shows that 21% of these study areas have less than 1000 lines, 47% less than 2500 lines and 80% less than 10,000 lines. In other words, almost 1000 carriers serve the equivalent of one central office code in a metropolitan area. Given this huge disparity, it should not be surprising to anyone that a single policy will not perform the same way for all carriers. There will be winners and losers. Thus, the very problem the Commission seeks to address, in this situation, adoption of a simple unified compensation scheme, can defeat the purpose the Commission has in mind, *i.e.*, the elimination of regulatory arbitrage.

## VI. THE COMMISSION DOES NOT HAVE ENOUGH INFORMATION TO MOVE FROM EMBEDDED COST TO FLEC FOR ACCESS.

As has been amply documented by the Rural Task Force in White Paper 4, the proxy cost model used by the Commission for the non-rural carriers is inappropriate for rural carriers.[44] Appendices C, D, and E accompanying this report provide specific tangible reasons and facts which demonstrates conclusively that the proxy model should not be used for rural carriers. Embedded cost continues to be the best way determine who should receive support and how much that support should be.

[44] *See, A Review of the FCC’s Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies*, White Paper 4, a report prepared by the Rural Task Force, an independent panel appointed by the Federal-State Joint Board on Universal Service, (September 2000).

NTCA has consistently criticized proposals to extend FLEC to rural LECs. In 1997, the Rural Telephone Coalition (RTC)[45] expressed "... concern about a potential Commission mandate to use any particular proxy model as a basis for universal service support, if such a model is based on a non-existent, optimally configured, hypothetical network and cannot be proven to accurately calculate the true forward-looking costs of an existing carrier."[46]

The RTC opposed the use of forward-looking incremental costs based on starting from a "blank technological slate" instead of those forward-looking costs the LEC will actually incur.[47] The RTC has also urged the Commission:

> "…to recognize that a true network is always a blend of the old and the new, with the new displacing the old when and where the economics justify the use of limited capital. Certainly, any model based on unlimited capital investment would be unreasonable. A model, if used for this purpose, must never rely on a simplistic flash-cut to the latest technology based on the most 'cost effective' use of that technology to meet all demand in an instantaneous, hypothetical manner. Such a network will never be constructed, and the development of any degree of competition will simply fragment the demand among the providers and their networks."[48]

The telephone and telecommunications network is continuously evolving. Rural companies continue to invest in their community networks. Estimates are made concerning future demand, the capability of the network to meet that demand, and the most cost effective way to grow the network to meet that demand. Cost effectiveness takes into consideration numerous factors, such as availability and cost of equipment,

---

[45] The Rural Telephone Coalition (RTC) is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA), and the Organization for the Promotion and Advancement of Small Telecommunications Companies (OPASTCO).

[46] *See,* Reply Comments of the Rural Telephone Coalition, CC Dockets 96-45 and 97-160, August 18, 1997 at 2.

[47] *See*, Petition for Reconsideration and Clarification of the RTC, CC Docket 96-45, July 17, 1997 at 10.

[48] *See*, Reply Comments of the Rural Telephone Coalition, CC Dockets 96-45 and 97-160, August 18, 1997 at 5 and 6.

cost to maintain equipment, cost to operate equipment, the cost and service implications attributable to various network architectures. Sometimes theses factors all point in the same direction, other times they are in conflict. However, a business decision must be made concerning the most prudent direction to take given the best available understanding of the future, the usefulness of the existing network in the future, the availability of capital to pay for investment and the likelihood of generating enough revenue from the investment to pay for it. No FLEC model can replace the sound judgment that must be exercised to keep companies on the sound financial basis that permits them to achieve the goals of universal service.

The recent financial struggles experienced by many new telecommunications firms reminds us all that it is not enough to have a modern state of the art network. The financial underpinnings must also be sound enough to survive adversity or the whole enterprise can become insolvent. Thanks to prudent planning, and a national commitment to universal service, incumbent rural LECs are providing modern service today and they are investing in Advanced Services. For example, In 2000, NTCA conducted a broadband survey of its members and 55% of NTCA members who participated said they were offering broadband service to residential customers .[49] It is difficult to see how rural companies can continue on this course in the environments the proposals would create

The critical question for rural America is what kind of service will they have 10, 15 or 20 years from now? Forward-looking rural policies by the Commission can contribute to a the continued availability of a high-quality rural network offering modern

---

[49] *See*, *NTCA Members Internet/Broadband Survey Report*, National Telephone Cooperative Association (November 2000) at 9.

state of the art services to rural America. The lack of sound rural policies will weaken the financial basis of rural ILECs and the inevitable result will be inferior out of date services in rural America. It will take financially strong companies to attract the capital investment necessary to afford to bring Advanced Services throughout rural America. The Commission should encourage rural LECs to continue to invest in rural areas rather than undermining their efforts with unproven theoretical concepts.

## VII. THE REGUILATORY FLEXABILITY ACT CANNOT BE COMPLIED WITH BECAUSE OF THE PREMATURE NPRM.

The Regulatory Flexibility Act of 1980 (RFA) requires federal agencies to "endeavor, consistent with the objectives of the rule and applicable statues, to fit regulatory and informational requirements to the scale of entities subject to the regulation. To achieve this principle, federal agencies are required to: 1) solicit and consider flexible regulatory proposals; and 2) explain the rationale for their actions to assure that flexible regulatory proposals are given serious consideration."[50]

For purposes of RFA analysis, the Commission defines a "small business" concern as one that is: 1) independently owned and operated; 2) having 1,500 or fewer employees; and 3) is not dominant in their field of operation. Previously, the Commission concluded that small ILECs did not meet the criteria of a small business because it considered them dominant in their field of operation. In 1999, the Small Business Administration's Office of Advocacy clarified that the Commission should consider small ILECs small businesses for RFA purposes since dominance in field of

---

[50] *See*, U.S. Small Business Administration, Office of Advocacy, *A Guide to the Regulatory Flexibility Act: An Implementation Guide for Federal Agencies*, p. 1 (1998). *See also*, 5 U.S.C. § 601.

operation is determined on a "national" scope.[51] Small and rural ILECs are clearly not dominant in the provision of local exchange service on a national basis. Therefore, the Commission includes small ILECs in its RFA analysis, but notes that its RFA action has no effect on Commission analyses and determinations in other, non-RFA contexts.

The Commission cannot meet the requirement of the RFA that it solicit and consider flexible and regulatory proposals and explain the impact of proposed rules on small carriers. The Commission is currently considering issues, such as access reform for ROR carriers, which must be resolved prior to consideration of the inter-carrier compensation regime proposed in this NPRM.

The NPRM seeks to look forward at the make up of a post access reform unified inter-carrier compensation regime. However, the MAG Plan which proposes access reform for ROR carriers is still pending before the agency with many issues unresolved. Small carriers must be provided regulatory certainty and predictability in order to consider the issues addressed in the NPRM and propose an alternative inter-carrier compensation methods. Large ILECs were provided this level of regulatory certainty and predictability with the adoption of the five-year CALLS access charge reform plan.

Several other issues should be resolved prior to further consideration of the NPRM on unified inter-carrier compensation. Currently, five Petitions for reconsideration are pending on portions of the Commission's ISP Reciprocal Compensation Order and seven petitions are pending on the CLEC Access Charge Order. Proposals in the unified inter-carrier compensation NPRM rely on rules from these orders

---

[51] *See* Letter from Jere W. Glover, Chief Counsel, and Eric E. Menge, Asst. Chief Counsel, SBA Office of Advocacy, to FCC Chairman William Kennard, 05/27/99.

that are currently subject to reconsideration. Some of the issues under reconsideration in these proceedings could have a direct impact on the NPRM.

Among the issues that must be resolved prior to further consideration of the NPRM are whether the Commission improperly preempted state commission jurisdiction to arbitrate and approve cost-based rates for the transport and termination of non-ISP section 251(b)(5) traffic in its ISP reciprocal compensation order. Adoption of a unified inter-carrier compensation NPRM before resolution of the Commission's jurisdiction over section 251(b)(5) traffic would cast a pall over the proceeding and would encourage court challenges.

Petitions for reconsideration are pending on portions of the Commission's Rural Task Force Order and on its universal service order considering disaggregation and the safety net and safety valve.

The culmination of regulatory uncertainty on ROR ILEC access charges, state and federal jurisdictional issues over section 251(b)(5) traffic, and pending changes to the universal service support mechanism make it impossible for rural carriers to adequately consider issues in the unified inter-carrier compensation NPRM and comment on alternative forms of inter-carrier compensation. The Commission is also handicapped because it cannot fulfill its RFA requirements until it can first determine how the intercarrier scheme it proposes will affect yet unadopted changes to its existing access charge rules for ROR carriers.

The myriad of unresolved variables outlined here demonstrate that consideration of the NPRM on unified inter-carrier compensation is premature at this time. The record warrants that the Commission convert this proceeding into a Notice of Inquiry or stay the

NPRM proceeding until final resolution on the MAG Plan for rural access charge reform and other key issues.

## VIII. CONCLUSION

For the above stated reasons, the Commission should delay this proceeding or convert it into a Notice of Inquiry.

NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

By: /s/ Scott Reiter
Scott Reiter
Senior Telecommunications Specialist
(703) 351-2015

By: /s/ Rick Schadelbauer
Rick Schadelbauer
Economic Analyst
(703) 351-2019

By: /s/ L. Marie Guillory
L. Marie Guillory
(703) 351-2021

By: /s/ Daniel Mitchell
Daniel Mitchell
(703) 351-2016

By: /s/ Jill Canfield
Jill Canfield
(703) 351-2020

Its Attorneys

4121 Wilson Blvd., Tenth Floor
Arlington, VA 22203-1801

August 21, 2001

CERTIFICATE OF SERVICE

I, Gail C. Malloy, certify that a copy of the foregoing Initial Comments of the National Telephone Cooperative Association in CC Docket No. 01-92, FCC 01-132, was served on this 21st day of August 2001 by first-class, U.S. Mail, postage prepaid, to the following persons

/s/ Gail C. Malloy
Gail C. Malloy

Chairman Michael Powell
Federal Communications Commission
445 12th Street, SW, Room 8B201
Washington, D.C. 20554

Commissioner Kathleen Q. Abernathy
Federal Communications Commission
445 12th Street, SW, Room 8-A204
Washington D.C. 20554

Commissioner Gloria Tristani
Federal Communications Commission
445 12th Street, S.W., Room 8-B115
Washington, D.C. 20554

Commissioner Kevin J. Martin
Federal Communications Commission
445 12th Street, S.W., Room 8-C302
Washington, D.C. 20554

Commissioner Michael J. Copps
Federal Communications Commission
445 12th Street, S.W., Room 8-A302
Washington, D.C. 20554

International Transcription Service
Federal Communications Commission
445 12th Street, S.W., Room CYB400
Washington, D.C. 20554

Magalie Roman Salas, Secretary
Federal Communications Commission
445 12th Street, SW, TW-A325
Washington, D.C. 20554

Paul Moon
Common Carrier Bureau
Federal Communications Commission
445 12th Street, S.W., Room 3-C-423
Washington, D.C. 20554

Jane Jackson
Common Carrier Bureau
Federal Communications Commission
445 12th Street, S.W., Room 5-A225
Washington, D.C. 20554